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IN THE

Supreme Court of the United States

October Term, 1970

No. .....

PIER 67, INC. a/k/a
EDGEWATER INN,
Petitioner,

v.

KING COUNTY, a Municipal Corporation;
A. J. STEEN as Assessor for King
County; and A. A. THEMPEN as
Treasurer for King County,
Washington,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF WASHINGTON

Petitioner, Pier 67, Inc., prays a Writ of Certiorari be issued to review the judgment and opinion of the Supreme Court of the State of Washington entered in this proceeding on May 20, 1970.

OPINION BELOW

The opinion of the Washington State Supreme Court is reported in 78 W.D.2d 48 (Adv. No. 1, June 5, 1970), a copy of which appears in the Appendix hereto.

JURISDICTION

The judgment of the Washington Supreme Court was entered on May 20, 1970. A timely petition for rehearing was denied on August 19, 1970 and this petition for certiorari was filed within 90 days of that date. This Court's jurisdiction is invoked under 20 U.S.C. §1257(3).

QUESTIONS PRESENTED

(1) Does the overruling of long standing statutory interpretations which retroactively increase petitioner's leasehold taxes but prospectively only affect similarly situated leaseholds deprive petitioner of the equal protection of the law.

(2) Does Washington law deprive petitioner of equal protection or deprive it of its property without due process by applying to petitioner's leasehold a standard of tax valuation which fails to approximate the true value of the leasehold by refusing to regard rent as a burden, thus including the rent paid to the tax-exempt state or federal lessor in the tax base of the lessee.

(3) Does an interpretive change of a tax statute which substantially increases the tax upon a prior leasehold of state property unconstitutionally impair the obligation of contracts.

Statutory and Constitutional Provisions Involved

United States Constitution, Amend. 14, Sec. 1:

> " • • • nor shall any state deprive any person of life, liberty or property, without due process of the law; nor deny to any person within its jurisdiction the equal protection of the law."

U.S. Constitution Art. VII, §1, Amend. 14:

> "• • • • All taxes shall be uniform upon the same class of property within the territorial limits of the authority levying the tax • • • ."

Washington State Constitution, Amend. 17:

> "Art. VII §2. *Forty Mill Limit*. Except as hereinafter provided and notwithstanding any other provision of this Constitution, the aggregate of all tax levies upon real and personal property by the state and all taxing districts now existing or hereafter created, shall not in any year exceed forty mills on the dollar of assessed valuation, which assessed valuation shall be fifty per centum of the true and fair value of such property in money:"

Washington Tax statutes, RCW 84.40.030:

> "84.40.030 Basis of valuation—Criterion of value—Growing crops excluded—Mines, quarries—Leaseholds. All property shall be assessed fifty percent of its true and fair value in money. In determining the true and fair value of real or personal property, the assessor shall not adopt a lower or different standard of value because the same is to serve as a basis of taxation; nor shall he adopt as a criterion of value the price for which the said property would sell at auction, or at a forced sale, or in the aggregate with all the property in the town or district; but he shall value each article or description of property by itself, and at such price as he believes the same to be fairly worth in money at the time such assessment is made. The true cash value of property shall be that value at which the property would be taken in payment of a just debt from a solvent debtor. In assessing any tract or lot of real property, the value of the land, exclusive of improvements, shall be determined; also, the value of all improvements and structures thereon and the aggregate value of the property, including all structures and other improvements, excluding the value of crops growing on cultivated lands. In valuing any real property on which there is a coal or other mine,

or stone or other quarry, the land shall be valued at such price as such land would sell at a fair, voluntary sale for cash; any improvements thereon shall be separately valued and assessed as hereinabove provided; and any personal property connected therewith shall be listed, valued and assessed separately as other personal property is assessed under general law. Taxable leasehold estates shall be valued at such price as they would bring at a fair, voluntary sale for cash."

STATEMENT OF THE CASE

The petitioner is a 30 year lessee of state-owned tidelands in Seattle, Washington, upon which it has constructed a large motor hotel, known as the Edgewater Inn. The state owns both the fee and improvements subject to petitioner's contractual right of user. opinion, p. 2, *infra*.

Petitioner commenced this action in November, 1964 to recover 1964 leasehold property taxes paid under protest. The grounds of the protest attached to the Complaint applicable to the constitutional issue were:

"(2) the said personal properties were assessed out of proportion to the value of other properties of like nature within the county;

"(3) the assessments of the properties involved violate the statutes and Constitution of the State of Washington and the Constitution of the United States requiring assessment of taxes to be on an equal basis for all classes of property;

"(4) the assessments of the subject properties is so arbitrary and capricious as to be inconsistent with the exercise of an honest judgment and so unequal and discriminatory as to violate the fundamental law of the land;

"(6) the assessment was made upon a fundamentally wrong basis resulting in the subject properties being valued without authority of law at a considerable

> higher percentage of value than other similar classes of property and not pursuant to the methods required by law;"

Respondent had taxed the improvements as being owned by petitioner. This assessment method was struck down in *Moses Lake Homes, Inc. v. Grant County, Washington*, 365 U.S. 744, 6 L.Ed.2d 66 (1961). The trial court held that the assessment method violated Washington statutes and was discriminatory in that other leaseholds of state and federal lands were taxed upon a different basis and at a lower rate. The trial court's order that the property be reassessed was affirmed on appeal, *Pier 67, Inc. v. King County*, 71 Wn.2d 92, 426 P.2d 610 (1967). The opinion held that petitioner's leasehold be assessed at what it would bring at a fair and voluntary sale for cash and that rental payments plus improvement mortgage amortization be deducted as an economic burden prior to capitalizing net income to determine the price a reasonable investing purchaser would pay.

Upon remand the assessor attempted to capitalize petitioner's net income for the tax years by now involved (1964-1967) but in determining net income, he refused to deduct annual payments of principal and interest upon the leasehold mortgage as he did in assessing leaseholds of other state lands.

The trial court then granted petitioner's motion for summary judgment determining the value of petitioner's leasehold interest for the tax years involved to be nil. The hotel's net earnings for the taxable years were exceeded by the total of the rent and mortgage payments due and thus a purchaser would pay nothing for the leasehold.

On the second appeal, the Washington Supreme Court reversed its earlier decision in this case and overruled a series of precedent decisons, termed the *Metropolitan Building Company* cases, the earliest being 1911, *Pier 67, Inc. v. King County*, 78 W.D.2d 48, — P.2d. ——.... ..... (Adv. No. 1, May 20, 1970).

Reasons for Granting Writ

1. For the Tax Years Involved, 1964 Through 1970, Petitioner's Leasehold Will Be Taxed by a Different Method and a Discriminatorily Higher Rate Than Other Leaseholds of State and Federal Tax-Exempt Land

Since all lessess of state and federal lands in Washington are involved, this question has an immediate importance beyond the particular facts and parites herein.

That to tax petitioner's leasehold in a manner different and substantially higher than similar leaseholds for particular tax years is unconstitutionally discriminatory, there can be no doubt. See for example *Phillips Chemical Co. v. Dumas Independent School Dist.*, 361 U.S. 376, 4 L.Ed.2d 384 (1960); and the cases cited in *Allied Stores of Ohio v. Bowers*, 358 U.S. 522, 3 L.Ed.2d 480 (1959). In *Raymond v. Chicago Union T. Co.*, 207 U.S. 20, 52 L.Ed. 78 (1907) syllabus 3 states:

> *"Constitutional law—equal protection of the laws—due process of law.*
>
> "3. Assessing the franchises and other property of certain corporations at a different rate and by a different method from that employed for other corporations of the same class for the same year, which results in enormous disparity and discrimination, denies the due process of law and equal protection of the laws pro-

> tected by U.S. Const., 14th Amend., against impairment by a state."

The court further states at 207 U.S. at p. 38, 52 L.Ed at p. 88:

> "It is not a question of mere difference of opinion as to the valuation of property, but it is a question of difference of method in the manner of assessing property of the same kind. Although the law itself may be valid and provide for a proper valuation, yet if, through mistake on the part of the state, through its board of equalization, and while acting as a quasi-judicial body, the board erred in the method to be pursued in relation to the corporations now before us, the mistake is one which may be corrected in equity [by this Court]."

See also *Moses Lake Homes, Inc. v. Grant County*, 365 U.S. 744, 6 L.Ed.2d 66 (1961) overruling 51 Wn.2d 285, 317 P.2d 1069 (1957). Grant County, Washington had attempted to tax a leasehold of exempt federal lands on a different and higher basis than the other leaseholds were assessed in Washington. The tax, obviously discriminatory, was held invalid.

2. The Washington Standard for Ad Valorem Taxation Is Now Too Vague and Taxes Values Which Neither Exist Nor Are a Part of Petitioner's Fractional Interest, Depriving It, and Lessees of Other Tax Exempt Federal and State Lands, of Property Without Due Process

As stated in *Great Northern R. Co. v. Weeks*, 297 U.S. 135 at 138-9, 80 L.Ed. 532 at 535-6 (1936):

> "The full and true value of the property is the amount that the owner would be entitled to receive as just compensation upon a taking of that property by the State or the United States in the exertion of the power of eminent domain. That value is the equivalent of the property, in money paid at the time of the

> taking. *Olson v. United States*, 292 U.S. 246, 254, 78 L.Ed. 1236, 1243, 54 S. Ct. 704. The principles governing the ascertainment of value for the purposes of taxation, are the same as those that control in condemnation cases, confiscation cases and generally in controversies involving the ascertainment of just compensation. *West v. Chesapeake & P. Teleph. Co.* 295 U.S. 662, 671, 79 L.Ed. 1640, 1646, 55 S. Ct. 894.

As to leaseholds, the Washington court disagrees, see opinion p. 11, *infra*.

> In *Weeks*, as here:
>
> "It clearly appears that the board failed to give reasonable weight to the falling off of petitioner's traffic, gross earnings, operating income, the extraordinary shrinkage in values of railroad properties, the prices of commodities and securities generally. The value of petitioner's property varied with the profitableness of its use, present and prospective." [citing cases]

See also *Quaker City Cab Co. v. Pennsylvania*, 277 U.S. 389, 72 L.Ed. 927 (1928); and *Rowley v. Chicago and Northwestern Ry. Co.*, 293 U.S. 102, 79 L.Ed. 222 (1934).

The "rental" and improvement mortgage payments paid or contracted to be paid by the lessee is no part of the value of a leasehold to the lessee. This "value" is only a value to the tax-exempt federal or state lessor. As in condemnations, all the lessee can sell is the value of his right of user and this may well be less than the rent reserved.

Whereas other properties in Washington are taxed at the price at which a willing owner can sell to a willing purchaser, the federal and state lessees are taxed not only on the basis of the benefits inherent in their property but their burdens as well. Leasehold improvement mortgage payments, where the improvement belongs to the lessor, are in practical effect the same as rent.

3. The Opinion Impairs the Contractual Obligations Between the State and Federal Governments on One Hand and Their Respective Lessees

Each government lessee entered this lease-contract with the state or federal government after projecting his costs, including taxes, against projected income. This was necessary in both bid and negotiated leases in order to compute the amount of rent which the lessee could pay and yet receive a reasonable return on his investment. The state, through its judiciary, simply amended the pre-existing tax laws governing state and federal leases. The question is then, does this constitute an impairment of the obligation of contract.

(a) *State Action*

The cases generally hold that the prohibition applies only to legislative and not judicial acts, see cases cited in 16 Am. Jur.2d at p. 799 but see *Douglass v. Pike County*, 101 U.S. 677, 25 L.Ed. 968 (1880) holding that when a statute becomes settled by judicial construction, contract rights acquired under it become as much a part of the statute as the text itself and a change of interpretation is as much an amendment to the law as is a legislative enactment. Further, such an amendment cannot be made retroactive. See also *Los Angeles v. Los Angeles City Water Co.*, 177 U.S. 558, 44 L.Ed. 886; *Schell v. Fauche*, 138 U.S. 562, 34 L.Ed. 1040; *German Sav. Bank v. Franklin County*, 128 U.S. 526, 32 L.Ed. 519; *Louisiana ex rel. Southern Bank v. Pilsbury*, 105 U.S. 278, 26 L.Ed. 1090. A "State" is prohibited from legislatively impairing existing contract rights. It should make no difference that a state court or a state legislature amends the statute. The paramount federal right to be protected should not depend

on the nature of the state agency making the legislative change.

(b) ***Does a Change in State Taxation Impair Prior Executed Contracts?***

Normally a lawful tax on a new subject or an increased tax on an old subject would not impair contract obligations, *North Missouri R. Co. v. Maguire*, 87 U.S. 46, 22 L.Ed. 287 (1874). However, under certain circumstances, a tax change will unconstitutionally impair the obligation of pre-existing contracts, *Puerto Rico v. Russell & Co.*, 315 U.S. 610, 86 L.Ed. 1062 (1942); *New Orleans Orphans' Asylum of Colored Children of Cincinnati v. Board of Tax Appeals*, 80 N.E.2d 761 (Ohio 1948); *Thompson v. Atlantic Coast L. R. Co.*, 38 S.E.2d 774 (Ga. 1946). See also the annotations found at 173 A.L.R. 15 (1948).

This would seem particularly appropriate when the state, as one of the contracting parties, itself alters the tax aspects of the contract. Here, the state entered into a lease on the basis of certain tax statutes, the effect of which is vital to the lessee in determining the amount of rental to be paid the state. Then, the state unilaterally increases the tax to effect increased income from its lessees in addition to the previously contracted-for rental. Surely the requirement of fair dealing applicable to ordinary contractees should apply to states.

We further point to the numerous federal lessees in Washington who are significantly involved. When problems of inter-governmental tax immunity are involved, this court looks more carefully at the contested state action, *Phillips Chemical Co. v. Dumas School Dist.*, *supra*, and *Moses Lake Homes, Inc. v. Grant County, Washington*, *supra*.

CONCLUSION

For these reasons a Writ of Certiorari should issue to review the judgment and opinion of the Washington State Supreme Court.

Respectfully submitted,

JENNINGS P. FELIX & ASSOCIATES
By JENNINGS P. FELIX
Counsel for Petitioner

APPENDIX A

IN THE SUPREME COURT OF THE STATE OF WASHINGTON

PIER 67, INC., a/k/a EDGEWATER INN,
Respondent,
v.
KING COUNTY, a Municipal Corporation; A. J. STEEN as Assessor for King County; and A. A. TREMPER as Treasurer for King County, Washington,
Appellants.

No. 40407
EN BANC

FILED
MAY 20, 1970

WEAVER, J.—Fundamentally, this case presents one problem: the standards of valuation and assessment, for tax purposes, applicable to a leasehold of tax-exempt land owned by the state in perpetuity within the boundaries of a harbor area as defined in Art. 15 of the Washington constitution.[1]

Plaintiff corporation leased the Seattle harbor land in question from the State of Washington for a period of 30 years. It improved the existing pier by building on it a motor hotel known as the Edgewater Inn. The hotel is permanent in nature and any attempt to remove it would result in its destruction. The buildings permanently erected became a part of the realty. The state owns both the fee

1. In *Pier 67 v. King Cy.*, 71 Wn.2d 92, 426 P.2d 610, (1967), the first appeal in the instant case, the court inaccurately identified the property involved as *tidelands*. It appears in the findings of fact that Pier 67 is within the boundaries of a *harbor area* and is governed by the constitutional provisions and statutes applicable thereto. RCW 79.01.508, *et seq.*

and the improvements, subject to plaintiff's contractual right of user.

This is an action to recover taxes paid under protest to defendant county. The county assessor, viewing the leasehold as personal property, maintained that the leasehold value was the cost of the improvements less depreciation. The trial court accepted plaintiff's theory of the case and ordered the leasehold reassessed. We affirmed that ruling in *Pier 67, Inc. v. King Cy.*, 71 Wn.2d 92, 426 P.2d 610 (1967). In doing so, however, the court laid down certain standards for valuation and assessment of leaseholds, based upon four early decisions of this court. *Metropolitan Bldg. Co. v. King Cy.*, 62 Wash. 409, 113 P. 1114 (1911); 64 Wash. 615, 117 P. 495 (1911); 72 Wash. 47, 129 P. 883 (1913); *In re Metropolitan Bldg. Co.*, 144 Wash. 469, 258 P. 473 (1927).

The standards used in the reassessment were again challenged. This time the trial court ordered that

> the true and fair market value for property tax purposes of the leasehold interest of the plaintiff herein . . . is zero, and the true and fair value of the personal property of the plaintiff other than the leasehold herein is $150,000 . . .[2]

The court determined the value of the leasehold for tax purposes to be zero because the hotel's net earnings in the taxable years were exceeded by the total of the rent and mortgage payments due. On this appeal, we conclude that this is error. The separate and individual rules of assessment laid down in the *Metropolitan Building Co.* cases, *supra*, when added together, produce an unrealistic result and are no longer the law of this jurisdiciton.

2. No error is assigned to the court's valuation of the personal property; hence, we do not consider it.

At the outset, plaintiff contends: (a) that the issues decided in the first appeal have become the law of the case, and we are precluded from considering them again; and (b) that the doctrine of stare decisis precludes us from reviewing the law of this jurisdiction, as announced in the *Metropolitan Building Co.* cases, *supra*. We do not agree with either contention as applied to the instant case.

In *Greene v. Rothschild*, 68 Wn.2d 1, 402 P.2d 356 (1965), we reversed our holding in a prior appeal of the same case. We held that the law-of-the-case doctrine is a self-imposed limit upon our power to review and is discretionary in operation. We concluded, therefore, that the doctrine does not curtail our jurisdiction should we decide, upon reflection, that a holding in a previous opinion in the same case is error.

The *Greene* opinion describes the circumstances in which this court will not apply the doctrine:

> Under the doctrine of "law of the case," as applied in this jurisdiction, the parties, the trial court, and this court are bound by the holdings of the court on a prior appeal until such time as they are "authoritatively overruled." [citations omitted]. Such a holding should be overruled if it lays down or tacitly applies a rule of law which is clearly erroneous, and if to apply the doctrine would work a manifest injustice to one party, whereas no corresponding injustice would result to the other party if the erroneous decision should be set aside.

It is not our intention to detract in any manner from the importance of the doctrine of stare decisis. The doctrine brings stability and continuity to the law; yet the magnitude of an error, spawned only 22 years after statehood, that permits private enterprise to minimize or escape taxation of leaseholds upon tax-exempt real property forces

us to conclude that the court must again address itself to issues previously raised.

> Stare decisis is a doctrine developed by courts to accomplish the requisite element of stability in court-made law, but is not an absolute impediment to change. Without the stabilizing effect of this doctrine, law could become subject to incautious action or the whims of current holders of judicial office. But we also recognize that stability should not be confused with perpetuity. If the law is to have a current relevance, courts must have and exert the capacity to change a rule of law when reason so requires. *In re Stranger Creek*, 77 W.D.2d 658, 661, 466 P.2d 508 (1970).

We proceed to the merits.

The general approach to *ad valorem* property taxation in Washington is stated in Art. 7, § 2 of the State Constitution: the taxable assessment shall equal ". . . fifty per centum of the true and fair value of such property in money." This provision applies to all property not exempt from taxation, and requires a uniform and equal rate of taxation on all property according to its value.

RCW 84.40.030 follows the constitution with the general standard of valuation:

> the assessor . . . shall value each article or description of property by itself, and at such price as he believes the same to be fairly worth in money at the time such assessment is made. The true cash value of property shall be that value at which the property would be taken in payment of a just debt from a solvent debtor. . . .

The same statute also provides:

> Taxable leasehold estates shall be valued at such price as they would bring at a fair, voluntary sale for cash.

Comparing these two provisions in *Eureka District Gold Mining Co. v. Ferry Cy.*, 23 Wash. 250, 259, 68 P. 727 (1902), the court said:

> We are unable to see any distinction in the result of applying the two rules. One taking property in payment of a debt from a solvent debtor would not be compelled to do so, and the act in so taking property would be as voluntary in estimating its cash value as though he were making a voluntary purchase for cash.

Clearly, the standards of valuation for assessing leaseholds are the same standards for valuing and assessing taxable property in general. *See Ozette R. Co. v. Grays Harbor Cy.*, 16 Wn.2d 459, 133 P.2d 983 (1943).

The county contends that rather than value taxable leasehold estates "at such a price as they would bring at a fair, voluntary sale for cash" it has the right, in the alternative, to assess the improvements on the land. It claims that this alternative springs from RCW 84.04.080:

> "Personal property" for the purposes of taxation, shall be held and construed to embrace and include, . . . *all leases of real property and leasehold interests therein for a term less than the life of the holder; [and] all improvements upon lands the fee of which is still vested in the United States, or in the state of Washington;* . . . (Italics our.)

The same statute (RCW 84.04.080), which defines "personal property" for the purposes of taxation, also provides:

> [N]o deduction shall hereafter be made or allowed on account of any indebtedness owed.

We disagree that the legislature, by passage of RCW 84.04.080 in its present form, intended to give the assessor the alternative to tax either the leasehold, as required by statute, or to tax the improvements thereon. A brief exam-

ination of the statute's legislative history shows why this alternative does not exist.

Commencing with the Revenue Law of 1891, it is clear that the legislature intended to tax the possessory interest in land of one either purchasing land from the state or in the process of acquiring title by virtue of homestead statutes.

Section 3 of the 1891 Revenue Law provided:

> Personal property for the purposes of taxation, shall be construed to embrace and include, . . . all *improvements* upon lands, the fee of which is still vested in the United States, or in the State of Washington, . . . (Laws of 1891, ch. 140, § 3, p. 280) (Italics ours.)

Section 24 of the 1891 Revenue Act provided:

> Property held under *a contract for the purchase* thereof, belonging to the state . . . shall be considered, for all purposes of taxation, as the property of the person so holding the same. (Laws of 1891, ch. 140, § 24, p. 290) (Italics ours.)

The meaning of the word "improvements," and the meaning of this provision within the definition of "personal property," is made clear by § 25 of the same act:

> The assessor must assess all improvements on public lands as personal property until the *settler* thereon has made final proof. After final proof has been made, and a certificate issued therefor, the land itself must be assessed, notwithstanding the patent has not been issued. (Laws of 1891, ch. 140, § 25, p. 290) (Italics ours.)

It is clear that these provisions applied to taxing as personal property improvements upon state-owned, tax-exempt real property when in the possession of a homesteader or of a vendee of the state.

In 1906 the taxability of leaseholds of state-owned, tax-exempt land was presented to the court in *Moeller v. Cormley*, 44 Wash. 465, 87 P. 507 (1906). It was an action to restrain King County from collecting *personal property* taxes on leasehold interests in state-owned, tax-exempt tidelands. The court held that under existing statutes the leasehold was not taxable as personal property, but was taxable as real property, "subject to the general rule of taxation." The court noted, however, that the then existing revenue law was probably inadequate to enforce tax collection when the leasehold of state-owned property was assessed as real property.

The court did not doubt that the legislature would "give the matter appropriate attention if it be called to its attention."

The legislature promptly gave "appropriate attention" by adopting Laws of 1907, ch. 108, § 1, p. 206:

> For the purposes of assessment and taxation all leases of real property and leasehold interests therein for a term less than the life of the holder, shall be and the same are hereby declared to be *personal property*. (Italics ours.)

This was the forerunner of our present statute, RCW 84.04.080. It is clear that leases were defined as personal property for purposes of taxation so that the leasehold interest might be taxed, and the tax collected, when the lease was on tax-exempt land.

It follows that the assessor does not have an alternative method of assessing leaseholds on tax-exempt land, for they are, as pointed out in *Moeller, supra*, "subject to the general rule of taxation" and "shall be valued at such price

as they would bring at a fair, voluntary sale for cash." RCW 84.40.030.

Further, the county argues it has a choice of taxing improvements rather than the leasehold, even though the improvements are a lesser interest than the leasehold estate of which they are a part. This theory of fragmenting property interests for the purpose of assessment is contrary to the theory of unit assessment that the court announced in *Trimble v. Seattle*, 64 Wash. 102, 116 P. 647 (1911), aff'd 231 U.S. 683, 58 L.Ed 435, 34 S. Ct. 218 (1914), and more recently in *Alaska Land Co. v. King Cy.*, 77 W.D.2d 248, 461 P.2d 339 (1969), and *Clark-Kunzl v. Williams and King Cy.*, ... W.D.2d ....., ... P.2d ..... (1970).

The only remaining question is whether the *Metropolitan Bldg. Co.* cases correctly interpreted the statutory standards for leasehold valuation. After a thorough re-examination of those cases, we have concluded that they represent a radical departure from the scheme of Washington ad valorem taxation.

In general these cases hold that the value of a leasehold of tax-exempt state real property for tax assessment is an amount equal to the excess, if any, of rents reserved and mortgage indebtedness. In the instant case, the amount is zero.

The result of such a method of valuation is to permit the lessee of state-owned, tax-exempt land to avoid taxation on a substantial portion of the value of his leasehold interest. To discover why the court reached this anomalous conclusion requires scrutiny of the cases themselves.

In 1907, the Metropolitan Building Company leased the

old University of Washington campus in what is now downtown Seattle. Being owned by the state, the land was tax-exempt. At substantial expense the lessee improved the property with large office buildings. Under the terms of the lease, the lessee was responsible for roads, sidewalks, sewers and other improvements to the land itself; it financed these improvements by the issuance of bonds.

The first case, *Metropolitan Bldg. Co. v. King Cy.*, 62 Wash. 409, 113 P. 1114 (1911), arose when in 1909 the county assessor assessed the leasehold in an amount based upon what the lessee "had put into the property." The court correctly held that the investment did not represent the leasehold's value, but then said:

> In determining the worth of a leasehold the courts have universally held that it is the value of the term less the *rent reserved*. (Italics ours)

The court recognized that the value of the leasehold term minus the rent reserved is the means used in calculating a lessee's damages when his leasehold is *condemned*. Condemnation valuation represents the lessee's *equity* in the leasehold; it is a *non sequitur* to say that it is its true value for *ad valorem* taxation. Taxation of property at its value, without regard to the owner's equity, is an established principal of *ad valorem* taxation.

Other states with property taxation statutes similar to ours distinguish leasehold valuation for the purpose of taxation from leasehold valuations in *eminent domain* proceedings. *See Texas Co. v. Cy. of Los Angeles*, 52 Cal.2d 55, 338 P.2d 440 (1959).

The distinction between the lessee's equity in a leasehold and the value of the leasehold estate for tax purposes is a

valid one. The fact that a leasehold interest has not appreciated does not mean that it is worth nothing. The value to be taxed is the value of the right to use the property over the period of the lease. This view is clearly set forth in *People ex rel. Kucharski v. T.W.A.*, 42 Ill.2d 174, 251 N.E.2d 225 (1969), in which a lessee of tax-exempt property argued that his lease was valueless because it showed no profit. The Illinois Supreme Court rejected the lessee's contention:

> [W]hat is being taxed is the value of the leasehold, in the sense of the price for which it can be sold, not the value of the leasehold *to the tenant*, in the sense of the profit that the tenant can make upon a sale of the lease. Contrary to the objector's suggestion, the fact that the lessee's net worth was not increased by entering into the lease does not affect the market value of the leasehold estate. 251 N.E.2d at 226.

The last two *Metropolitan Bldg. Co.* cases added a further qualification to leasehold valuation: mortgaged indebtedness, as well as rents reserved, was to be deducted in assessing leasehold value. In *Metropolitan Bldg. Co. v. King Cy.*, 64 Wash. 615, 117 P. 495 (1911), the court struck down an assessment it considered excessive, on the ground that the leasehold had little or no salable value in the taxable year, since its income did not exceed the total of rents reserved and mortgage payments. In the third case, *Metropolitan Bldg. Co. v. King Cy.*, 72 Wash. 47, 129 P. 883 (1913), the court reviewed the past two cases and held:

> The testimony shows that the leasehold, measured by its burdens and benefits, has no real market value, . . . The leasehold is burdened by a debt exceeding the value placed upon the lease by most of the witnesses. A purchaser of the lease would necessarily stand in the shoes of the respondent. [taxpayer] . . .

> . . . We say here, as we have said before, that the value of the leasehold interest is to be measured both by its burdens and benefits.

The court left unmentioned the rule of RCW 84.04.080 that no deduction be allowed for indebtedness owed. It simply reiterated the logic of the first two cases: the taxable value was determined to be the lessee's *equity* or the amount in excess of his capital indebtedness.

The final opinion, *In re Metropolitan Bldg. Co.*, 144 Wash. 469, 258 P. 473 (1927), attempted to resolve the incongruity between the prior *Metropolitan* cases and the prohibition of indebtedness deductions found in RCW 84.04.080. The court rationalized that allowing deductions for mortgaged indebtedness did not violate the statute; it merely provided an easy means to amortize the capital investments in improvements:

> The improvements become the property of the state as and when made, and the leaseholder, before any profit can be figured, must provide by some plan of amortization for the return of the money invested in the improvements, together with reasonable interest thereon during the time it is so invested.

We now conclude that this was error.

In measuring fair market value and complying with the mandate of the statutes, the assessor has a number of appraisal methods at his disposal. Normally a taxable property is appraised by a number of methods and the results of each are collated into a single figure representing the assessed value. *See The Valuation of Leaseholds for Ad Valorem Property Tax Purposes—The Reasonable Assessor Standard*, 1968 Wash. U. L. Quarterly 136 (1968).

RCW 84.40.030 states a standard by which valuation

is to be determined, but it makes no single method of appraisal mandatory. The legislature did, however, provide in RCW 84.04.080 that no deduction be allowed for any indebtedness owed. It is clear that the legislature did not contemplate appraising a leasehold in the manner required by the last Metropolitan case.

The market value of a leasehold is to be measured by considering both benefits to be garnered from the use of the property over the term of the lease and the burdens placed upon it. Burdens on the leasehold are restrictions which limit its use. These burdens may arise from zoning ordinances or other legal limits on land use or may be restrictions imposed by the terms of the lease itself.

Indebtedness does not represent a burden on the leasehold. Though it may be a burden on the lessee, we have already concluded that the *ad valorem* tax is not on the lessee's equity; it is on the value of the leasehold term. *De Luz Homes v. San Diego Cy.*, 45 Cal.2d 546, 290 P.2d 544 (1955).

The benefits of a leasehold may stem from its economic productivity. It cannot be valued without reasonable knowledge of its probable remaining life. Further, an option to renew the lease may increase the value of the leasehold because it may afford an opportunity to extend the duration of benefits.

These are some of the factors the assessor may take into consideration, but they are not exclusive.

The ultimate responsibility of the assessor is to determine the true cash value of the property. No "rule of thumb" can be formulated to fit every situation; but the

assessor must consider all relevant circumstances pertinent and helpful in making his assessment within the ambit of the applicable statutes. An assesment which meets this test will not be set aside by the courts unless the property is so grossly overvalued as to result in a fraud upon the property owner. *Templeton v. Pierce Cy.*, 25 Wash. 377, 65 P. 553 (1901); *Alaska Land Co. v. King Cy.*, 77 W.D.2d 248, 461 P.2d 339 (1969).

In the instant case, when the trial court fixed the assessed value of plaintiff's leasehold interest at zero, it followed our previous opinions and applied doctrines which we now overrule.

The order and judgment fixing the value of the leasehold at zero during the taxable years involved is reversed.

s/ WEAVER J.

We concur:

s/ HUNTER, C. J.
s/ FINLEY, J.
s/ ROSELLINI, J.
s/ HAMILTON, J.
s/ HALE, J.
s/ NEILL, J.
s/ STAFFORD, J.
s/ HILL, J. PRO TEM

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J. ROBERT SEAVER, CLERK

IN THE

Supreme Court of the United States

October Term, 1970
No. 780

PIER 67, INC. a/k/a
EDGEWATER INN,
Petitioner,

v.

KING COUNTY, a Municipal Corporation;
A. J. STIER as Assessor for King
County; and A. A. TAUFFER as
Treasurer for King County,
Washington,
Respondents.

On Petition for a Writ of Certiorari to the Supreme Court of the State of Washington

BRIEF ON BEHALF OF LEASEHOLD TAX STUDY COMMITTEE AS AMICUS CURIAE IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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IN THE

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KING COUNTY, a Municipal Corporation;
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STATEMENT IN SUPPORT OF PETITIONER PIER 67, INC.

The Leasehold Tax Study Committee supports Pier 67, Inc.'s Petition for Certiorari. The parties have consented to the filing of this brief by the Leasehold Tax Study Committee as *amicus curiae*. Their written consents have been filed with the Clerk of the Court.

BROAD IMPACT OF PIER 67, INC. DECISION — AFFECTED LESSEES

The number of lessees that will be affected by the decision of the Washington Supreme Court in *Pier 67, Inc. v. King County*, 78 W.D.2d 48 ..... P.2d ..... (1970), hereinafter called The Pier 67, Inc. decision, can only be estimated at this time. All lessees of the United States, the State, or any county or municipal corporations within the State of Washington will be affected. Indications are that some of the taxing authorities are considering extending the principles of the Pier 67, Inc. decision to interests in land not generally considered as being leasehold estates.

It is estimated that the decision will affect:

(a) Approximately 5,000 leases from the State of Wasington, including about 2,000 grazing and agricultural leases.

(b) More than 2,500 leases from the U.S. Forest Service, of which approximately 1,750 are for recreational use and 750 for commercial use.

(c) More than 4,000 grazing and agricultural leases, including about 2,000 from the State of Washington.

(d) Several hundred and perhaps more than 1,000 leases from port districts of properties located on waterfronts, in industrial parks or at airports.

(e) An as yet undetermined number of leases from other Federal agencies, counties or municipal corporations.

It is reasonable to conclude that if the Pier 67, Inc. decision is not reversed, other states may follow the decision and compound the constitutional and other errors by affecting lessees in those other states.

THE LEASEHOLD TAX STUDY COMMITTEE

The Leasehold Tax Study Committee was formed followng a statewide meeting of those affected by the decision to determine what action could and should be taken and how to implement such action. The Committee has determined that it should support Pier 67, Inc.'s Petition for Certiorari.

CONSTITUTIONAL ISSUES

The constitutional issues are discussed in the Pier 67, Inc. Petition for Certiorari and will not be repeated in this brief, except to further emphasize how the Pier 67, Inc. decision prejudicially impairs existing contracts.

For more than 60 years prior to the Pier 67, Inc. decision, it was the well-settled rule in Washington that leaseholds of public lands were taxable, and that the rent reserved was a burden under the lease in determining the value of taxable leasehold estates. If the lease rent was equal to or greater than the economic rent, then the leasehold had no value for *ad valorem* tax purposes. The state and county taxing authorities have construed the Pier 67, Inc. decision as permitting leases of tax exempt lands to be valued for *ad valorem* tax purposes by determining the present worth of the beneficial rights as if held in perpetuity and deducting only the present worth of the reversionary interest of the lessor, and as eliminating rent as a burden in determining the value of the leasehold estate. If the lease is for a long term, the value of the leasehold estate could approach the value of the fee because the value of the reversion will be minimal. The tax imposed on the leasehold would then be almost equal to the tax that would be imposed upon the property if it were privately owned.

Following is an example of how the decision prejudicially impairs existing contracts:

Assume two identical properties, each having a full fair rental value of $100 per month. One parcel is privately owned and taxable and the other is publicly owned tax exempt property. Prior to the Pier 67, Inc. decision, the lessees negotiate identical leases calling for rental payments of $100 per month. In other words, the lease rent and the economic rent are equal.

Of the amount paid to the private lessor, a hypothetical $85.00 is retained by the private lessor and the remainder, $15.00, is passed on to the county by reason of *ad valorem* taxes on the property. No tax is paid by the lessee on its leasehold estate either before or after the Pier 67, Inc. decision. The total cost to the lessee of such private property is, therefore, $100.00 per month.

Of the amount paid to the governmental lessor, the entire $100.00 is retained by the lessor as there is no tax on it or its property. The $15.00 that would have gone to the county if the property had been privately owned is retained by the governmental lessor for its operating purposes. Prior to the Pier 67, Inc. decision the leasehold estate would not have had any value for *ad valorem* tax purposes because the lease rent and economic rent were equal. Because of the Pier 67, Inc. decision, the county will assess a tax upon the leessee's leasehold estate which will be in addition to the agreed rental of $100.00 per month. If the lease is for a long term, the value of the reversion will be minimal and the tax imposed will be almost the same as the tax that would be imposed upon the property if it were privately owned.

In this example, the lessee of tax exempt property will be required to pay almost $115.00 per month, which is significantly more than the fair rental value of the property. The prejudicial impact upon a lessee whose rent is $10,000 per month or more, and there are some in the State of Washington, is obvious.

CONCLUSION

The decision of the Supreme Court of the State of Washington will affect several thousand lessees of tax exempt lands located in the State of Washington. It may have an affect on the lessees of tax exempt lands in other states. A thorough review of the judgment and opinoin of the Pier 67, Inc. decision is required because of the constitutional issues raised therein, the large number of leases and lessees affected by these constitutional issues and the inequitable consequences which will result from a failure to review and remedy the constitutional errors in the decision. The petition for certiorari should be granted.

Respectfully submitted,

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